BEFORE THE
SURFACE TRANSPORTATION BOARD

WESTERN FUELS ASSOCIATION, INC. and BASIN ELECTRIC POWER COOPERATIVE, INC. Complainants, v. BNSF RAILWAY COMPANY Defendant.	Docket No. 42088

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COMPLAINANTS' REPLY IN OPPOSITION TO DEFENDANT'S MOTION TO STRIKE

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WESTERN FUELS ASSOCIATION, INC. and BASIN ELECTRIC POWER COOPERATIVE, INC.

By: John H. LeSeur
Christopher A. Mills
Peter A. Pfohl
Daniel M. Jaffe
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

Attorneys for Complainants

OF COUNSEL:

Slover & Loftus LLP
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170

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Complainants Western Fuels Association, Inc. and Basin Electric Power Cooperative, Inc. (collectively "WFA") file this Reply in Opposition to BNSF Railway Company's ("BNSF's") Motion to Strike ("Motion" or "Motion to Strike") and in support hereof state as follows:

PREFACE

On November 22, 2010, BNSF filed its Comments on Remand ("Comments"). As directed by the Board in its Order served on February 1, 2011, WFA filed its Reply ("Reply") to BNSF's Comments on March 18, 2011. The Board's February 1, 2011 Order did not authorize BNSF to file a reply, and replies to replies are prohibited under the Board's Rules of Practice. *See* 49 C.F.R. § 1104.13(c) ("A reply to a reply is not permitted.").

BNSF has repeatedly ignored the Board's Rules by filing documents in this proceeding styled as "motions to strike" that are in fact impermissible replies to WFA's filings. The Board has rejected BNSF's abuse of the Board's Rules and twice before denied BNSF's attempts to file an impermissible reply under the guise of a motion to strike. *See W. Fuels Ass'n, Inc. & Basin Elec. Power Coop. v. BNSF Ry.*, STB Docket No. 42088 (STB served Feb. 18, 2009) at 4 ("*Feb. 2009 Decision*") (denying BNSF's motion to strike portions of WFA's rebuttal evidence); *id.* (STB served Sept. 10, 2007) at 5-6 ("*Sept. 2007 Decision*") (same). BNSF's latest Motion to Strike should be summarily denied for the same reasons.

BACKGROUND

The issue in this remanded proceeding is a very limited one: the Court of Appeals directed the Board to expressly address BNSF's contention that the Board's Modified Average Total Cost ("ATC") methodology double-counted variable costs.[1] In its Comments, BNSF argued that Modified ATC did double-count variable costs and urged the Board to calculate cross-over traffic revenue allocations on remand using Original ATC. BNSF's retained consultants, Michael R. Baranowski and Benton V. Fisher ("Baranowski/Fisher"), provided an array of hypothetical examples BNSF claimed supported its side-bar contentions that Original ATC fairly allocated cross-over traffic revenues while Modified ATC did not.

[1] *BNSF Ry. v. STB*, 604 F.3d 602, 613 (D.C. Cir. 2010).

In its Reply, WFA demonstrated that Modified ATC does not double-count variable costs. As WFA explained, Modified ATC is a two-step process where in Step 1 revenues are allocated to cover variable costs, and, in Step 2, contribution is allocated using a total cost metric. WFA also demonstrated that Modified ATC produces a fair, logical and unbiased allocation of cross-over traffic revenues whereas Original ATC does not. As part of this later demonstration, WFA's expert economist, Mr. Thomas D. Crowley, carefully reviewed the hypothetical examples presented by Baranowski/Fisher in support of BNSF's revenue allocation contentions, and refuted them.

In its Motion to Strike, BNSF asks the Board to strike pages 19 to 41 of Mr. Crowley's Reply Verified Statement ("Crowley Reply Statement"). This portion of Mr. Crowley's Reply Statement demonstrates that the conclusions reached by Baranowski/ Fisher are wrong. BNSF also asks the Board to strike pages 34 to 37 of WFA's Reply Argument. This portion of WFA's argument summarizes some of the points made by Mr. Crowley in his critique of Baranowski/Fisher's analysis. BNSF claims that these pages should be stricken because "this material constitutes an impermissible collateral attack on the principles" set forth in *Major Issues in Rail Rate Cases,* STB Ex Parte No. 657 (Sub-No. 1) (STB served Oct. 30, 2006) ("*Major Issues*"). Motion to Strike at 1. BNSF also claims that some of Mr. Crowley's analysis employs flawed logic.

ARGUMENT

BNSF's Motion is an exercise in misdirection. There is no legal basis to strike portions of WFA's Reply because the material BNSF seeks to strike was presented in direct response to arguments raised by BNSF in its Comments. *See Feb. 2009 Decision* at 4 (denying BNSF's motion to strike because the material BNSF sought to strike "was in direct response to BNSF's [prior] argument"). What BNSF really wants to do is to respond to the merits of WFA's Reply without asking permission to do so.

BNSF's first asserted new merits argument – that WFA's defense of Modified ATC is inconsistent with the principles set forth in *Major Issues* – is patently false. In its Reply, WFA defended Modified ATC, a procedure the Board has repeatedly held is consistent with *Major Issues*. BNSF's second new merits argument – that WFA's evidence refuting BNSF's attack on Modified ATC contains flawed reasoning – is also totally without merit.

I.

WFA PROPERLY RESPONDED TO BNSF'S COMMENTS

BNSF seeks to strike pages 19 to 41 of Mr. Crowley's Reply Statement. This portion of Mr. Crowley's Reply Statement responds to BNSF's arguments that Modified ATC does not produce a fair allocation of cross-over traffic revenues. The specific points made by Mr. Crowley at pages 19 to 41 of his Reply Statement are succinctly summarized in his topic headings:

- Modified ATC does not dilute the fixed cost weighting (pp. 19-25);

- Modified ATC does not break revenue and cost alignments (pp. 25-28);
- Modified ATC correctly captures scale economies and per unit profitability (pp. 28-33);
- Modified ATC equitably allocates revenues (pp. 33-37); and
- Modified ATC does not improperly shift revenue (pp. 37-41).

Each of the points made by Mr. Crowley was in direct response to arguments made by BNSF Counsel, and/or its witnesses Baranowski/Fisher, who contended:

- Modified ATC dilutes fixed cost weighting. Baranowski/Fisher V.S. at 11 (Modified ATC "dilute[es] . . . the relative weighting of fixed costs");
- Modified ATC breaks revenue and cost alignments. *See id.* at 17 (Modified ATC "consistently allocates to the SARR revenues that exceed its proportionate share of total costs");
- Modified ATC does not correctly capture scale economies and per unit profitability. BNSF Arg. at 2 (ATC fails to "appropriately consider economies of density");
- Modified ATC does not equitably allocate revenues. *Id.* at 13 (Modified ATC "biases and distorts the SAC results in favor of complaining shippers"); and
- Modified ATC improperly shifts revenues. Baranowski/Fisher V.S. at 9 (Modified ATC inappropriately "transfers . . . more revenue to the SARR").

There is no legal basis to strike pages 19 to 41 of Mr. Crowley's Reply Statement because Mr. Crowley's points are directly responsive to arguments made by BNSF in its Comments.[2] Nor is there any basis for granting BNSF's request that the Board strike pages 34-37 of WFA's Reply Argument, as the argument on those pages simply summarizes Mr. Crowley's points.

II.

BNSF'S "COLLATERAL ATTACK" CONTENTIONS ARE FRIVOLOUS

BNSF claims that WFA's Reply contains "an impermissible collateral attack" on the cross-over revenue allocation principles set forth in *Major Issues*. Motion at 1. That accusation is false. WFA did not "repudiate" the principles set forth in *Major Issues*, it embraced them.

The Board ruled in its prior decisions in this case that the Original ATC methodology, which was a one-step procedure, needed to be refined into a two-step Modified ATC procedure where revenue was first allocated to cover on-SARR and off-SARR variable costs, and contribution was then allocated using the Original ATC procedure. *See Sept. 2007 Decision* at 14; Decision served Feb. 29, 2008 at 4-5 ("*Feb.*

[2] The legal authorities cited by BNSF are inapposite. *See McCarty Farms v. Burlington N. Inc.*, ICC Docket No. 37809 (ICC decided May 22, 1987) 1987 WL 98562, at *2 (ICC strikes portions of a BNSF reply filing that did not address points raised by complainant McCarty Farms); *James Rifkin D/B/A N. Cent. R.R. – Acquisition & Operation Exemption – in York Cnty., Pa.*, STB Finance Docket No. 34501 (STB served Feb. 23, 2005) at 4 (STB strikes railroad construction notice filed in the wrong STB docket); *Otter Tail Power Co. v. BNSF Ry.*, STB Docket No. 42071 (STB served Jan. 27, 2006) at 4 (STB strikes shipper's cost of capital evidence in shipper's rebuttal filing where shipper presented cost of capital evidence on opening; BNSF accepted this

2008 Decision"); *Feb. 2009 Decision* at 12-13.

The Board also has repeatedly held that use of the two-step Modified ATC procedure "is reasonable and consistent with our objective in *Major Issues*" whereas use of Original ATC "conflicts" with these objectives and produces "biased" revenue allocations:

> This refinement [i.e., adoption of Modified ATC] is reasonable and consistent with our objective in *Major Issues*. Traffic must cover its variable costs before it can be expected to make any contribution to joint and common costs. Therefore the objective is how to allocate revenue *contribution* (if any is available) [in Step 2 of Modified ATC]. . . . [Use of Original ATC] would plainly conflict with our express purpose to find a non-biased, cost-based method [to allocate cross-over traffic revenues]. *See Major Issues* at 32.

Sept. 2007 Decision at 14 (emphasis in original). *Accord Feb. 2008 Decision* at 4; *Feb. 2009 Decision* at 12-13.

In its Reply Comments, WFA defended the Board's Modified ATC methodology and refuted BNSF's claims that Original ATC should be substituted for Modified ATC. It is the height of irresponsible advocacy for BNSF to claim that WFA's defense of Modified ATC – an approach the Board has found "is reasonable and consistent with . . . *Major Issues* " – is somehow an impermissible "collateral attack" on *Major Issues*. Similarly, there is absolutely no credible basis for BNSF to contend that WFA's critique of Original ATC – a methodology the Board has concluded "plainly conflict[s]" with the principles set forth in *Major Issues* – somehow constitutes a

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evidence on reply; and the shipper attempted to change this evidence on rebuttal).

"collateral attack" on the principles set forth in *Major Issues*. The only "impermissible collateral attack" here is BNSF's efforts to try to revive the discredited Original ATC methodology.

BNSF points specifically to one passage in the Board's decision in *Major Issues* as the basis for its "collateral attack" arguments. That passage states: "A successful allocation of cross-over revenues would produce the same revenue-to-cost relationship as would be produced if the complainant modeled the entire movement." Motion at 7 (quoting *Major Issues* at 35). BNSF argues that Original ATC meets this test, but Modified ATC does not. BNSF is wrong. Modified ATC does maintain the "same revenue-to-cost relationship," but does so in two steps, not one. In Step 1, allocation of revenues up to variable cost levels produces the same revenue-to-variable cost relationship for the on-SARR and off-SARR segments, with the revenue-to-variable cost ("R/VC") ratio capped at 1.0. In Step 2, contribution is allocated using average total costs, which produces the same contribution-to-total cost relationship for the on-SARR and off-SARR segments.

Finally, BNSF argues that in defending Modified ATC, WFA is "repris[ing]" the same arguments that shippers presented in *Major Issues*, and the Board rejected. Motion at 14. This argument is also wrong. In *Major Issues*, most shippers argued that the Board should retain the Modified Straight-Mileage Prorate ("MSP") method – a methodology designed to approximate relative variable costs – to set cross-over traffic revenues. In its Reply, WFA did not ask the Board to set cross-over traffic divisions using MSP, even though MSP has no fixed cost component and would have provided far more revenues to WFA's SARR than Modified ATC. *See* Reply at 37. Instead, WFA advocated that the Board reaffirm its prior decision to set cross-over traffic revenues using Modified ATC.

III.

BNSF'S FEEBLE EFFORTS TO REHABILITATE ITS FLAWED HYPOTHETICALS ARE MERITLESS

In its prior decisions in this case, the Board found that application of Original ATC produced "illogical and unintended result[s]" when applied to low R/VC ratio moves. *See Sept. 2007 Decision* at 14. *Accord Feb. 2008 Decision* at 4-5; *Feb. 2009 Decision* at 13. As the Board pointed out, application of Original ATC on low R/VC ratio moves produced revenue allocations in some cases where the origin-to-destination movement had an R/VC ratio equal to or greater than 1.00 but, using ATC, the high-density on-SARR segment was allocated less revenue than its variable costs while the low-density off-SARR segment received revenues in excess of its variable costs. The Board also found that Modified ATC resolved this "illogical and unintended result" by ensuring in Step 1 that revenues were first allocated to cover on-SARR and off-SARR variable costs.

In BNSF's Comments, Baranowski/Fisher presented hypotheticals they claimed demonstrated that Original ATC did not produce "illogical and unintended results" when applied to low R/VC ratio moves. WFA's expert, Mr. Crowley, reviewed these hypotheticals and demonstrated that the Board's concerns were well-founded. It is clear that Original ATC produces absurd results when applied to low R/VC ratio moves and it is also clear that Modified ATC solves this fundamental defect in Original ATC.

Mr. Crowley also demonstrated that Original ATC produced illogical and unintended results when applied to high R/VC ratio moves. Mr. Crowley did so simply by restating the Baranowski/Fisher hypothetical revenue allocation examples and expanding them to include a broader range of revenue and cost inputs. In its Motion, BNSF takes issue with two of Mr. Crowley's restated hypotheticals, but BNSF's attempts to challenge Mr. Crowley's analysis simply confirm that his analysis is correct:

- **Table 3** – Baranowski/Fisher presented a hypothetical summarized in their Table 2, which they claimed demonstrated that "modified ATC understates the weight given to fixed costs on movements generating different levels of contribution." *Id.* V.S. at 15. Mr. Crowley pointed out that Baranowski/Fisher's hypotheticals were based only on low R/VC ratio moves. His Table 3 restated and expanded the Baranowski/Fisher Table 2 hypotheticals to include higher R/VC ratio moves. Mr. Crowley's Table 3 clearly shows that Modified ATC does not systematically understate or overstate the "weight" given fixed costs at different R/VC ratios, whereas Original ATC does overstate the weight given fixed costs on both high and low R/VC ratio moves. Crowley V.S. at 23.

BNSF now concedes that on high R/VC ratio moves in the hypothetical, "fixed costs . . . are over-weighted" using the Original ATC revenue allocation procedure, but argues that this is not a problem because "variable costs are [also] overweighted" and the variable and fixed costs "are overweighted to the same extent." Motion at 12. The error in BNSF's logic is self-evident. Variable and fixed costs used in Original ATC and Modified ATC are fixed dollar amounts. The "weight" given to fixed costs when compared to total revenues – which was the metric selected by Baranowski/Fisher in their Table 2 – turns on the relationship of the fixed figures to total revenues and whether this "weight" is understated or overstated using BNSF's weighting metric turns on the revenue levels involved – which was the point of Mr. Crowley's Table 3. BNSF now appears to agree with Mr. Crowley's point.

- **Table 7** – Mr. Crowley's Table 7 illustrates a hypothetical cross-over traffic revenue allocation, using Original ATC and Modified ATC, for a movement with an R/VC ratio of 220%. Under the hypothetical, both the on-SARR and off-SARR segments are the same length and are allocated revenues in excess of their full variable plus full fixed costs, but under Original ATC the SARR is allocated less profit per ton (contribution above total cost) than the residual incumbent. Mr. Crowley correctly observed in his Reply Statement that the result using Original ATC is absurd because the more profitable high density SARR segment is allocated less per unit profit. Modified ATC produces the economically correct result – the more profitable high density SARR segment is allocated more per unit profit. Crowley V.S. at 28-31.

In its Motion, BNSF argues that Mr. Crowley's Table 7 analysis is flawed because per unit dollar amounts are not the correct metric for evaluating profit. *Id.* at 13. BNSF's argument ignores the basic economic principles that the Board concluded necessitated the use of a cost based metric for allocating cross-over traffic revenue. As the Board explained in *Major Issues*:

> Like all capital-intensive industries, the railroad industry is characterized by economies of density, meaning the average total cost for a network of a given size initially decreases with increases in output.

Id. at 26.

The "average total cost" referenced by the Board is the average per unit total cost. Per unit fixed costs go down as density increases. The corollary is that the per unit profit goes up as density increases. Therefore, for analysis purposes, profits are properly measured on a per unit basis. Moreover, the very construct of both Original and Modified ATC is based on the ratio of average per unit costs of the cross-over traffic segments. Since it is proper to base the revenue allocation ratio on per unit costs, then it is clearly proper to evaluate the results of the application of that ratio on a per unit basis as well.

CONCLUSION

WFA respectfully requests that the Board deny BNSF's Motion to Strike for the reasons set forth above.

Respectfully submitted,

WESTERN FUELS ASSOCIATION, INC. and BASIN ELECTRIC POWER COOPERATIVE, INC.

By: John H. LeSeur JHL
Christopher A. Mills
Peter A. Pfohl
Daniel M. Jaffe
1224 Seventeenth Street, N.W.
Washington, D.C. 20036

Attorneys for Complainants

OF COUNSEL:

Slover & Loftus LLP
1224 Seventeenth Street, N.W.
Washington, D.C. 20036
(202) 347-7170

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CERTIFICATE OF SERVICE

I hereby certify that this 27th day of April, 2011, I served copies of the foregoing Reply in Opposition by hand delivery on designated outside counsel for BNSF, as follows:

Samuel M. Sipe, Jr.
Anthony J. LaRocca
Frederick J. Horne
Steptoe & Johnson, LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036

Peter A. Pfohl